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SUBJECT: CALDERON SUBMITS 2009 BUDGET TO CONGRESS; SPENDING ON
SECURITY AND SOCIAL PROGRAMS ARE UP

Summary

1. (U) With oil revenues down, President Calderon submitted a 2009 federal budget proposal that increases spending on security and social programs. The proposed budget, presented to the Chamber of Deputies on Sept. 8, rose by 5.7 percent in real terms over the budget approved in 2008. Spending for security and social development programs, Calderon's top priorities, significantly rose by 33 and 6 percent respectively. With oil output and revenue declining, the government is cutting gasoline subsidies gradually. The budget proposal does not yet incorporate the energy reform currently being discussed in the Congress. For the first time in 15 years, the budget does not include changes to the tax system. A major challenge for the administration will be to improve its timely execution of expenditures in 2009, especially those for infrastructure. End summary.

Economic outlook for 2009; decline in oil output noted

2. (U) Calderon's 2009 budget is based on assumptions of 3 percent real GDP growth, annual inflation of 3.8 percent, with an average 28 day-CETES rate of 8 percent, a current account deficit of 1.1 percent of GDP, and a Mexican oil mix price of \$ 80.3 per barrel as determined by a formula set in the Budget and Fiscal Responsibility Law enacted in 2006 (Note: The Finance Secretariat is expecting an average Mexican oil mix price of \$ 96.50 per barrel in 2009. End Note). A decline of 3.8 and 8.6 percent in oil production and exports are expected for 2009 to total 2.75 million and 1.33 million barrels a day, respectively, largely due to the drop in Cantarell field's output. The Finance Secretariat (Hacienda) explains that the decline in Cantarell's production will be partially offset by the expected output increase in other fields, such as Ku-Maloob-Zaap.

Budget proposal is balanced

3. (U) Consistent with the Budget and Fiscal Responsibility Law, the Executive sent a balanced budget, which includes the revenue and spending bills. Expenditures and revenue total 2.82 trillion pesos (US\$ 269 billion), a 5.7 percent increase over the budget approved

in 2008, but only 0.4 percent higher than the estimated budget to be actually exercised in 2008 (US\$ 268 billion). Proposed programmable expenditures are 2.11 trillion pesos (US\$ 202 billion), up 6.3 percent from 2008 in real terms and the highest ever approved in Mexico's history.

¶4. (U) The budget is balanced using the narrow definition of the budget balance, but the broader measure of the budget balance -- the Public Sector Borrowing Requirement (PSBR), which includes off-budget items, such as the banking and highway bailouts - will be equivalent of 2 percent of GDP. The historical balance of the Public Sector's Borrowing Requirements (HBBR) will be equivalent to 30.5 percent of GDP. (Note: HBBR is the public sector's net total debt measured by the net stock of liabilities that result from subtracting total available financial assets from total liabilities. End Note) The 2009 budget proposal considers a results-based budgeting process, as well as performance evaluations and compliance measurements of government programs' goals. For the first time ever, Calderon is proposing multi-annual investment budgets for infrastructure projects aimed at propelling the National Infrastructure Plan (NIP).

Top priorities are security and social development

¶5. (U) The public spending strategy for 2009 will focus on security and justice, and social development, health and education. The 2009 budget includes more funds for overall expenditures for security and justice to fight organized crime and kidnapping, and social development to tackle poverty. Overall expenditures for security and justice will grow by 32.9 percent in annual terms. Spending in

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social development programs will rise 6 percent in annual terms.

6.(U) The 2009 budget for the Public Security Secretariat, the Attorney General's Office, the National Defense Secretariat and the Secretariat of the Interior will be increased by 49.8, 29.2, 16.1 and 25.1 percent in real terms, respectively. The Social Development Secretariat will see its budget grow by 25.9 percent in annual terms and the National Council of Science and Technology's budget will register an increase of 24.7 percent. On the other hand, budgetary resources for the Secretariats of Communications and Transportation, Agriculture, Tourism and Environment will be reduced by 19.9, 9.4, 4 and 2.5 percent, respectively.

No tax changes in 2009

¶7. (U) For the first time in 15 years, the 2009 budget will not include changes to the tax system or "Miscelanea Fiscal" as it's known in Mexico, because the government is still implementing the changes approved in last year's fiscal reform package. Under this reform, for instance, the single corporate tax rate (IETU) will increase from 16.5 percent in 2008 to 17 percent in 2009. Also, collections from the tax on cash bank deposits implemented in July are expected to grow by 147.4 percent. Moreover, the Tax Administration Service (SAT, the rough equivalent of the IRS) will continue simplifying the system to make it easier for taxpayers to fulfill their obligations, as well as implement tools to tackle tax evasion.

Proposed energy reform not factored into budget

¶8. (U) The economic package does not yet include any changes related to the energy reform currently being discussed by the Congress. Once Congress approves the reform, legislators will have to incorporate the changes to the revenue bill. The energy reform is expected to be approved before October 20, when the Chamber of Deputies must approve the revenue bill. The Senate must approve it no later than October 31. The spending part of the package must be approved by the Chamber of Deputies no later than November 15.

Infrastructure budget and off-budget resources

¶9. (U) It is worth noting the 19.9 percent reduction in the Secretariat of Communications and Transportation's (SCT) budget this year, which is partially explained by the significant resources SCT has received in the past and the additional resources it is expected to obtain from the launch of pending highway bids. The government will also be able to execute multi-annual budgets for projects included in the National Infrastructure Plan. The government's goal is to invest the equivalent of 5 percent of GDP in the coming years, which is expected to be accomplished via budget resources: direct allotments and long-debt investment instruments PidiREGAS, and off-budget resources. The Secretariat of Communication and Transportation has also embarked on a major investment plan that involves public-private partnerships included in the National Infrastructure Plan (NIP).

Comment

¶10. (SBU) To some extent, the 2009 budget is more austere than in other years given the expected decline in oil output, crude oil price and increasingly expensive gasoline imports. As a result, the government has announced its intention to gradually cut gasoline subsidies in half by 2010. The increase in public security and social development is fully consistent with Calderon's public pledge of fighting narco-trafficking and organized crime, and of tackling Mexico's stubborn poverty rate.

¶11. (SBU) A major challenge for the administration will be to improve the timely execution of expenditures, especially those for infrastructure. For the past two years, the federal government has

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found this difficult due to a poor of planning, bureaucratic procedures, and delays in signing execution agreements with local governments for the use of federal resources and land. We expect Congress to likely perform some surgery on Calderon's budget to funnel more resources to highway infrastructure, support payments to the agricultural sector, and a reduction of social development funds. End Comment.